



STATE OF WASHINGTON
DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF CONSUMER SERVICES

P.O. Box 41200 • Olympia, Washington 98504-1200
Telephone (360) 902-8703 • TDD (360) 664-8126 • FAX (360) 664-2258 •
<http://www.dfi.wa.gov/cs>

December 5, 2003

Interpretive Letter 03-01-CL

Re: Washington prohibition on prepayment penalties

Dear Consumer Loan Licensee:

This interpretative letter addresses the prohibition on prepayment penalties on loans made under Washington's Consumer Loan Act, Chapter 31.04 RCW (the Consumer Loan Act). Pursuant to WAC 208-620-130(7), "[a] licensee may not collect a prepayment penalty on any loan made at rates authorized by the act."¹

In 1982, the United States Congress enacted the Alternative Mortgage Transaction Parity Act (AMTPA), 12 U.S.C. §§ 3801 – 3806, inclusive. AMTPA was intended to create parity among all residential mortgage lenders nationwide concerning the terms and conditions of "alternative mortgage transactions."² Congress enacted AMTPA in the belief that federal regulation of alternative mortgage terms was necessary to allow lenders in the home equity lending market to compete on an equal footing with national banks and federal savings associations. Pursuant to 12 U.S.C. § 3803 of AMTPA, Congress delegated to three federal regulators the authority to implement and enforce regulations that would fulfill its legislative intent:

- The Office of the Comptroller of the Currency (OCC) was given authority over banks;
- The National Credit Union Administration (NCUA) was given authority over credit unions; and
- The Office of Thrift Supervision (OTS) was given authority over federal savings associations, mutual savings banks, savings banks and non-chartered "state housing creditors."

¹ It is the Department's opinion that inclusion of a prepayment penalty in the note presumes intent to collect, regardless of actual collection.

² See statutory definition, AMTPA, 12 U.S.C. §3802. Alternative mortgage transactions include, but are not limited to, adjustable rate mortgages (ARMs), home equity lines of credit (HELOCs) and balloon mortgages. Alternative mortgage transactions do not include non-mortgage extensions of credit.

The OTS has determined that leveling of the lending market as to alternative mortgages is no longer necessary. Pursuant to its authority under AMTPA, the OTS, on September 26, 2002, adopted and published amendments to 12 C.F.R. § 560.220 of its AMTPA regulations, effective January 1, 2003. One amendment affects “state housing creditors,” including those licensed under the Consumer Loan Act. One of these amendments removes the federal preemption of state prohibitions on prepayment penalties with respect to *alternative mortgage transactions*. This limited federal preemption had provided most of our licensees with the ability to charge prepayment penalties on *alternative mortgage transactions* made under the Consumer Loan Act.

On December 6, 2002, the OTS delayed the effective date of the regulation to July 1, 2003. Thereafter, the National Home Equity Mortgage Association (NHEMA) filed a federal civil action to suspend implementation of the final rule. On July 14, 2003, the court in the case ruled in favor of the OTS. See *National Home Equity Mortgage Association vs. Office of Thrift Supervision*, 2003 U.S. Dist. LEXIS 12109 (U.S.D.C. – D.C., July 14, 2003).

Consequently, the Washington State rule prohibiting prepayment penalties on loans made at rates authorized under the Consumer Loan Act³, is, on or after July 1, 2003, no longer preempted by the OTS AMTPA regulation. However, pursuant to the Depository Institutions Deregulatory and Monetary Control Act of 1980 (DIDMCA), at 12 U.S.C. §1735f-7a, creditors, as defined under that Act, continue to enjoy a federal preemption on first lien mortgage loans.

What does this mean to Washington consumer loan licensees?

Effective July 1, 2003:

- 1. Consumer loan licensees previously accessing the OTS AMTPA preemption that are “creditors” under DIDMCA are prohibited from collecting prepayment penalties on all junior lien mortgage loans and other non-mortgage loans made at rates authorized under the Consumer Loan Act; and***
- 2. Consumer loan licensees that are not “creditors” under DIDMCA are prohibited from charging prepayment penalties on any loan made at rates authorized under the Consumer Loan Act.***

The Department of Financial Institutions will review mortgage loans made under the Consumer Loan Act as of July 1, 2003, to determine compliance with the prepayment penalty prohibition pursuant to WAC 208-620-130(7). The improper inclusion of prepayment penalties in these loans will be cited as a violation. Refunds will be required

³ Pursuant to RCW 31.04.105(1), Every licensee may lend money at a rate that does not exceed twenty-five percent per annum as determined by the simple interest method of calculating interest owed.

where necessary, and there will be the potential of enforcement action taken against licensees violating this rule.

Please immediately modify your lending practices and documents to comply with this interpretive letter and make any appropriate refunds for prepayment penalties already collected in violation of the rule.

Sincerely,

A handwritten signature in black ink, appearing to read 'Chuck Cross', with a stylized flourish at the end.

Chuck Cross
Acting Director/Enforcement Chief